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Safety & Soundness

Federal Reserve Adopts Final Rule Establishing New Regulation XX, Concentration Limits for Large Financial Companies

On November 5, 2014, the Federal Reserve Board (Federal Reserve) adopted a final rule that creates a new Regulation XX to govern implementation of Section 622 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). Section 622 establishes a financial sector concentration limit that generally prohibits a financial company from combining with another company if the ratio of the resulting company's liabilities exceeds 10 percent of the aggregate consolidated liabilities of all financial companies.

The final rule, which becomes effective on January 1, 2015, also establishes reporting requirements for financial companies that do not otherwise report consolidated financial information to the Federal Reserve or other federal banking agency to implement Section 14 of the *Bank Holding Company Act*.

The final rule is substantially similar to the proposal issued in May 2014, but in response to comments, the Federal Reserve:

- Made a change to stipulate that if a financial company has reached the 10 percent concentration limit, the company could not acquire control of another company under merchant banking authority.
- Added an exemption to clarify that a financial company may continue to engage in securitization activities if it has reached the limit.

Similar to the proposal, liabilities of a financial institution are generally defined as the difference between its risk-weighted assets, as adjusted to reflect exposures deducted from regulatory capital, and its total regulatory capital. Firms not subject to consolidated risk-based capital rules would measure liabilities using generally accepted accounting standards.

Financial companies subject to the limit include insured depository institutions, bank holding companies, savings and loan holding companies, foreign banking organizations, companies that control insured depository institutions, and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve.

FSB and Basel Committee Update List of G-SIBs

On November 6, 2014, the Financial Stability Board (FSB) and the Bank for International Settlements' Basel Committee on Bank Supervision (Basel Committee) announced they have updated their list of global systemically important banks (G-SIBs), using year-end data for 2013 and the updated assessment methodology published by the Basel Committee in July 2013. One bank has been added to the list of G-SIBs that were identified in 2013, increasing the overall number from 29 to 30.

Coincident with the announcement, the Basel Committee published a technical summary of the methodology and the denominators used to calculate banks' scores for the 2013 exercise and the thresholds used to allocate the banks to buckets for purposes of calculating the higher loss absorbency (HLA) requirements specific to each institution.

FFIEC Releases Cybersecurity Assessment Observations and Recommends Participation in Information Sharing and Analysis Center

On behalf of its members, the Federal Financial Institutions Examination Council (FFIEC) released the *FFIEC Cybersecurity Assessment General Observations* (Cybersecurity Assessment) and the *Cybersecurity Threat and Vulnerability Monitoring and Sharing Statement* on November 3, 2014.

The Cybersecurity Assessment addresses findings from the 2014 Cybersecurity Assessment pilot examination work program in which the preparedness to mitigate cyber risks at over 500 community financial institutions were evaluated. The Cybersecurity Assessment presents general observations about the range of inherent risks and the varied risk management practices among financial institutions. It also suggests questions for chief executive officers and boards of directors to consider when assessing their financial institutions' cybersecurity risks and preparedness.

As a result of the Cybersecurity Assessment, FFIEC members are reviewing and updating current guidance to align with changing cybersecurity risk. However, the FFIEC stated that the Cybersecurity Assessment should not be construed as guidance.

The *Cybersecurity Threat and Vulnerability Monitoring and Sharing Statement* encourages regulated financial institutions of all sizes to participate in the Financial Services Information Sharing and Analysis Center (FS-ISAC), a nonprofit, information-sharing forum. FS-ISAC was established by financial services industry participants to facilitate the public and private sectors' sharing of physical and cybersecurity threat and vulnerability information.

The members of the FFIEC include the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation, the Consumer Financial Protection Bureau, the National Credit Union Administration, and the State Liaison Committee. Coincident with the release, the OCC released Bulletin 2014-53 advising national banks and federal savings associations of the need to understand their inherent cybersecurity risks and to consider their related current practices and overall preparedness.

FSB Publishes Progress Report on Sound Compensation Practices and Implementation Standards

On November 4, 2014, the Financial Stability Board (FSB) published its third progress report on the implementation of the FSB *Principles for Sound Compensation Practices* and their *Implementation Standards* (together, P&S) by FSB jurisdictions. The report:

- Summarizes the main findings of responses to the annual monitoring questionnaire, providing information on recent actions and initiatives by FSB jurisdictions to implement the P&S since the August 2013 progress report; and
- Incorporates the results of a survey conducted in late 2013 regarding material risk takers (MRTs) and malus/clawbacks, and the findings of the second FSB workshop with private sector participants held in April 2014 that focused on: identification and treatment of MRTs; the use of malus and clawback clauses as part of the alignment of compensation with risk taking and performance; and governance frameworks, including the role of

compensation structures in supporting a sound risk and compliance culture at financial institutions.

The report finds that the implementation of the P&S is essentially complete but that some challenges remain with regard to:

- The application of risk metrics at the level of business units, products, and individual employees;
- A more transparent and consistent application of policies to guide the use of discretion in setting compensation; and
- The availability of better data and disclosures to support the effective alignment of compensation with prudent risk-taking behavior.

The report also finds that significant differences remain among jurisdictions in the approach to, and implications of, identifying MRTs as well as that more work is needed to ensure the P&S implementation leads to more prudent risk-taking behavior. The report recommends that FSB jurisdictions further improve the intensity and effectiveness of their supervision of compensation practices, and continue to foster the use of firms' malus and clawback mechanisms.

Agencies' Shared National Credits Review Indicates High Risk in Credit Portfolios

On November 7, 2014, the Federal Reserve Board, the Office of Comptroller of the Currency, and the Federal Deposit Insurance Corporation (the Agencies) released the results of the annual *Shared National Credits* (SNC) review. In a supplemental report, the Agencies highlighted findings specific to leveraged lending.

The SNC review indicates that the credit quality of large loan commitments owned by U.S. banking organizations, foreign banking organizations, and nonbanks is generally unchanged in 2014 from the prior year. The volume of criticized assets remained elevated at $340.8 billion, or 10.1 percent of total commitments, which is approximately double pre-crisis levels. The stagnation in credit quality follows three consecutive years of improvements. Notably, leveraged loans accounted for nearly 75 percent of these criticized SNC assets.

The leveraged loan supplement identifies several areas where institutions need to strengthen compliance with the March 2013 guidance, including provisions addressing borrower repayment capacity, leverage, underwriting, and enterprise valuation. In addition, examiners noted risk-management weaknesses at several institutions engaged in leveraged lending, including:

- Lack of adequate support for enterprise valuations and reliance on dated valuations;
- Weaknesses in credit analysis; and
- Overreliance on sponsor's projections.

As a result of the SNC review, the Agencies intend to increase the frequency of leveraged lending reviews to ensure the level of risk is identified and managed.

Coincident with the release of the SNC review results, the Agencies released answers to FAQs on related guidance intended to advance industry and examiner understanding and promote consistent application in policy formulation, implementation, and regulatory supervisory assessments.

Agencies Announce EGRPRA Outreach Meetings

The Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (Agencies) announced they will hold a series of outreach meetings to review their regulations under the *Economic Growth and Regulatory Paperwork Reduction Act* (EGRPRA). The first outreach meeting will be held at the Los Angeles branch of the Federal Reserve Bank of San Francisco on December 2, 2014; Outreach meetings in other cities are planned throughout 2015.

The outreach meeting will feature panel presentations by industry participants and consumer and community groups. Interested persons will have an opportunity to present their views on any of the twelve categories of regulations listed in a June *Federal Register* notice. State banking regulators are invited to participate in the outreach meetings through the State Liaison Committee of the Federal Financial Institutions Examination Council (FFIEC). Registration information can be found through the FFIEC Web site.

Enterprise & Consumer Compliance

CFPB Issues Report Highlighting Debt Collection Complaints of Older Consumers

On November 5, 2014, the Consumer Financial Protection Bureau (CFPB or Bureau) released a report entitled, *A snapshot of debt collection complaints submitted by older consumers*. The report indicates that between July 10, 2013, and September 30, 2014, more than a third of the 25,800 complaints the CFPB handled from older consumers were related to debt collection. The complaints cited that debt collectors:

- Attempt to collect debts that are not owed by the consumer (e.g., cases of misidentification or debts that are covered by insurance);
- Do not provide sufficient information to identify a debt; and
- Use abusive collection tactics, including the use of intimidating and derogatory language.

The Bureau stated that older consumers complained particularly about collections related to medical debt and debts of deceased family members for which they are not liable.

To coordinate with the release of the "snapshot report," the CFPB also issued a consumer advisory that provides information about how consumers may:

- Obtain information about debt they do not recognize;
- Dispute a debt;
- Stop harassing or offensive contact from debt collectors; and
- Become knowledgeable about the protections from garnishment that federal benefits have in debt collection.

Capital Markets & Investment Management

CFTC Issues Interpretation Regarding Notification and Reporting Requirements for Uncleared Swap Transactions

The U.S. Commodity Futures Trading Commission's (CFTC) Division of Swap Dealer and Intermediary Oversight (DSIO) issued an interpretation on October 31, 2014, that provides guidance regarding the applicability of certain provisions of Commission Regulations 23.701 and 23.704. These regulations, among other things, impose certain notification and reporting requirements on swap dealers (SDs) and major swap participants (MSPs) with respect to margin posted by their counterparties in uncleared swap transactions.

The interpretation responds to several inquiries received by the DSIO regarding the applicability of these regulations under certain situations. In general, the interpretation clarifies:

- The requirement that an SD or MSP must provide annual notification to each counterparty to an uncleared swap transaction of such counterparty's right to elect to require segregation of initial margin continues to apply in any calendar year in which the SD or MSP enters into a new uncleared swap transaction with the counterparty. The SD or MSP is required to provide the annual notification whether or not the counterparty previously made an election to require the SD or MSP to segregate initial margin;
- The annual notification and quarterly reporting requirements set forth in Regulations 23.701 and 23.704 are not applicable if no initial margin is required to be posted by a counterparty or collected by an SD or MSP either by contract or regulation; and
- Under certain conditions an SD or MSP is not prohibited from relying on negative consent in complying with its obligations to obtain from its counterparty: (a) confirmation of the counterparty's receipt of the annual notice provided by the SD or MSP under Regulation 23.701, and (b) the counterparty's election to require or not require segregation.

FSB Publishes Progress Report on OTC Derivatives Market Reforms

The Financial Stability Board (FSB) published its eighth progress report on implementation of over-the-counter (OTC) derivatives market reforms on November 7, 2014. The reforms, which were agreed by the G20 Leaders in 2009, are intended to improve transparency, mitigate systemic risk, and protect against market abuse.

The report indicates that progress has continued to be made in reform areas across the FSB member jurisdictions and further progress is anticipated for 2015. The main findings are:

- The adoption of legislation is nearing completion, with the greatest progress to date being made in adopting regulations implementing higher capital requirements for non-centrally cleared derivatives and trade reporting requirements. Implementation in other reform areas is also proceeding, though timetables stretch well into 2015 and beyond. Measures to promote trading on exchanges or electronic trading platforms continue to take longer than those in other reform areas.

- International standards and guidance in key areas (such as bank capital requirements for central clearing exposures, and recovery and resolution for financial market infrastructures) have been finalized over the course of 2014.
- Bilateral and multilateral discussions addressing outstanding cross-border issues have intensified over the course of 2014.
- The availability of market infrastructure, and market participants' use of that infrastructure, continues to gradually broaden across jurisdictions.

FINRA Investor Survey Reveals Support for Additional Regulatory Protections

The Financial Industry Regulatory Authority (FINRA) released the results of a survey of U.S. investors designed to assess investor attitudes regarding current regulatory protections, measure their perceptions about fairness, and gauge their demand for additional regulatory protections. The online survey of 1,000 individuals indicated that 92 percent of investors agreed a regulator was necessary to protect investors and police the markets, and 74 percent of those investors would support additional regulatory protections to safeguard them from misconduct by brokers or brokerage firms.

Highlights of the survey findings include:

- 88 percent of investors believe it is moderately or very important for regulators to detect when unsuitable securities are being sold to investors.
- 90 percent believe it is moderately or very important for regulators to detect when brokers are making trades that benefit themselves and not the investor.
- 89 percent believe it is moderately or very important for regulators to detect when firms are taking risks that potentially harm their investors and the financial system.

CFTC Releases Fiscal Year 2014 Enforcement Results

On November 6, 2014, the U.S. Commodity Futures Trading Commission (CFTC) reported that during fiscal year 2014, it obtained a record $3.27 billion in monetary sanctions imposed against companies and individuals. The CFTC filed 67 new enforcement actions, and a number of litigations from prior years reached successful resolutions, either through settlement, the granting of summary judgment, or a finding of liability after trial.

The $3.27 billion in sanctions includes more than $1.8 billion in civil monetary penalties and more than $1.4 billion in restitution and disgorgement. The CFTC stated that its more than $5 billion in total monetary sanctions over the past two fiscal years is more than the total sanctions imposed during the prior ten fiscal years combined.

Enforcement Actions

The Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) recently announced the following enforcement actions:

- The SEC charged two foreign citizens with conducting an international microcap pump-and-dump scheme that generated more than $17 million in proceeds. The SEC is seeking a permanent injunction, disgorgement with prejudgment interest, civil penalties, repatriation of assets, and penny stock bars.

- The SEC charged ten companies for failing to make the required disclosures about financing deals and other unregistered sales that diluted their stock. The companies all agreed to settle the SEC's charges, and the agency assessed a total of $350,000 in penalties.
- The SEC sanctioned 13 brokerage firms for improper sales below a $100,000 minimum denomination set in a $3.5 billion offering of junk bonds by a foreign country. The enforcement actions are the SEC's first under Municipal Securities Rulemaking Board (MSRB) Rule G-15(f), which establishes the minimum denomination requirement. Each firm agreed to settle the SEC's charges and pay penalties ranging from $54,000 to $130,000. Without admitting or denying the findings, each of the firms agreed to be censured and to review their policies and procedures. The SEC's investigation is continuing.
- The SEC charged a California-based company with violating the *Foreign Corrupt Practices Act* (FCPA) when its subsidiaries made payments of $7.5 million to foreign officials in three countries in order to win business and the company earned $35 million in illicit profits. The company self-reported its misconduct and agreed to pay $55 million to settle the SEC's charges and a parallel U.S. Department of Justice action.
- The SEC charged a city in Michigan and two former city leaders with fraud in connection with a municipal bond offering. Without admitting or denying the charges, the city and the two officials agreed to settle the SEC's charges. The city agreed to implement certain remedial measures. Both officials are permanently barred from municipal bond offerings and one official was fined $10,000.
- The SEC charged an attorney and two other individuals with defrauding investors in a pump-and-dump scheme that netted the individuals approximately $3 million in illicit proceeds. The SEC is seeking disgorgement plus interest and penalties as well as penny stock bars and permanent injunctions. The SEC is also seeking to bar the attorney from serving as an officer or director of any public company. In a parallel case, the U.S. Attorney's Office announced criminal charges against them.
- The CFTC announced that a U.S. District Court entered a restraining Order freezing assets and prohibiting the destruction or concealment of books and records of two unregistered commodity pool firms and one individual. The court's Order arises out of a CFTC complaint alleging that the firms and the individual acted as unregistered commodity pool operators and used fictitious trading account statements to fraudulently solicit at least $700,000 from investors, and they commingled pool funds with a non-pool property. The CFTC seeks disgorgement, restitution, civil monetary penalties, permanent registration and trading bans, and a permanent injunction.

Recent Supervisory Actions against Financial Institutions

Last Updated: November 7, 2014

Agency	Institution Type	Action	Date	Synopsis of Action
CFPB	State Member Bank	Consent Order	10/09	The Consumer Financial Protection Bureau assessed financial penalties on a financial services entity for engaging in unfair, deceptive, or abusive acts or practices, related to its deceptive advertising of free checking accounts for consumers.
CFPB	Title Insurance Agency	Consent Order	09/30	The Consumer Financial Protection Bureau announced that it had assessed financial penalties on an insurance agency for entering into quid pro quo agreements with companies that referred business to its mortgage closings and title insurance businesses in violation of the *Real Estate Settlements and Procedures Act.*
CFPB	Federal Savings Bank	Consent Order	09/29	The Consumer Financial Protection Bureau assessed financial penalties on a federal savings bank and loan servicer related to its default servicing practices that violated the loss mitigation provisions of the *Real Estate Settlement Procedures Act.* Mortgage Servicing Rule.
FDIC	State Nonmember Bank	Consent Order	09/29	The Federal Deposit Insurance Corporation assessed financial penalties on a financial services entity for unfair and deceptive practices related to marketing and servicing of credit card add-on products, in violation of the *Federal Trade Commission Act.*
CFPB and OCC	National Bank	Individual Consent Orders	09/25	The Consumer Financial Protection Bureau and the Office of the Comptroller of the Currency assessed financial penalties on a large financial services entity for unfair billing of identity theft protection products in violation of the *Federal Trade Commission Act*.
Federal Trade Commission	Nonbank Debt Collector	Complaint	09/23	The Federal Trade Commission charged a nonbank debt collector that used fictitious names and threatened consumers into paying debts they may not have owed in violation of the *Federal Trade Commission Act* (FTC Act) and *the Fair Debt Collection Practices Act* (FDCPA).
Federal Reserve Board	State Member Bank	Written agreement	09/19	The Federal Reserve entered into a written agreement with a Massachusetts-based state member bank to address an unauthorized cash dividend to shareholders. The Federal Reserve objected to the capital plan the bank submitted in January 2014.
CFPB	Nonbank Payday Lender	Complaint	09/17	The Consumer Financial Protection Bureau charged a Missouri-based payday lender with originating online payday loans without consumers' consent and debiting fees from their checking accounts in violation of the *Consumer Financial Protection Act*, the *Truth in Lending Act*, and the *Electronic Fund Transfer Act* (EFTA).
CFPB	Nonbank For-Profit Educational Institution	Complaint	09/16	The Consumer Financial Protection Bureau charged a California-based, publicly traded, for-profit college chain with operating an illegal predatory lending scheme in violation of the *Consumer Financial Protection Act* and the *Fair Debt Collection Practices Act*. .

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This is a publication of KPMG's Financial Services Regulatory Practice and KPMG's Americas' FS Regulatory Center of Excellence

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